STATE OF IOWA

DEPARTMENT OF COMMERCE

UTILITIES BOARD

IN RE: QWEST CORPORATION	DOCKET NO. RPU-01-6

PROPOSED DECISION AND ORDER

(Issued March 25, 2002)

SYNOPSIS[1]

On June 22, 2001, Qwest Corporation (Qwest) filed proposed wholesale prices for services and new unbundled network elements (UNEs). On July 12, 2001, the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed an objection to the proposed prices. The Utilities Board (Board) docketed the filing for investigation.

There are only two contested issues in this case. Both relate to prices to be charged for line sharing. A single copper loop between the customer and the telephone company may be shared, so that an incumbent local exchange carrier (ILEC), such as Qwest, provides the voice telephone service over the low frequency portion of the loop to the customer, and a competitive local exchange carrier (CLEC) or data local exchange carrier (DLEC) provides data service over the high frequency part of the loop (HFPL) to the same customer. This separate provisioning of services over the low and high frequency parts of the loop is called line sharing.

The first contested issue is the wholesale price Qwest will be allowed to charge competitors for the HFPL. Qwest has proposed both a recurring, monthly charge and a nonrecurring, per loop charge that competitors would pay to lease the HFPL. Only the amount for the recurring, monthly charge is contested. This decision finds that the recurring, monthly charge for the HFPL should be $0. The nonrecurring proposed price of $38.62 per loop for each shared loop for the HFPL is uncontested and is approved.

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[1] The purpose of this synopsis is to provide readers a brief summary of the decision. While the synopsis reflects the order, it will not be considered to limit, define, amend, or otherwise affect the body of the order including the findings of fact and conclusions of law.

The second contested issue is the wholesale price Qwest may charge its competitors to recover costs it incurred in modifying its operations support systems (OSS)[2] to support line sharing. This decision sets a recurring, monthly charge of $1.02 for recovery of OSS modification costs.

Qwest also proposed prices for many other unbundled network elements (UNEs) and services. These proposed prices were uncontested, and are approved.

APPEARANCES

DAVID SATHER, 925 High Street 9 S 9, Des Moines, Iowa 50309; TODD L. LUNDY and JOSEPH V. HATALA, Qwest Corporation, 1801 California Street, Suite 4900, Denver, Colorado 80202; and JOHN M. DEVANEY, Perkins Coie LLP, 607 Fourteenth Street N.W., Suite 800, Washington, D.C. 20005-2011; appearing on behalf of Qwest Corporation.

JOHN R. PERKINS and DONALD G. HENRY, appearing on behalf of the Iowa Department of Justice, Office of Consumer Advocate.

NANCY S. BOYD and JAMES L. PRAY, Brown, Winick, Graves, Gross, Baskerville and Schoenebaum, P.L.C., Suite 1100, Two Ruan Center, 601 Locust Street, Des Moines, Iowa 50309-3765; and JULIE THOMAS BOWLES, Sprint Communications Company L.P., 8140 Ward Parkway, 5E, Kansas City, Missouri 64114; appearing on behalf of Sprint Communications Company L.P.

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[2] OSS are the computer databases and other systems maintained by ILECs that allow their employees to process customer orders for services, provide the requested services to customers, maintain and repair network facilities, and bill customers. CLECs need access to the ILEC's OSS to provide services to their own customers.

PROCEDURAL HISTORY

Qwest made its initial filing in this docket on June 22, 2001. The initial filing included direct testimony of seven Qwest witnesses, public and confidential exhibits, and electronic copies of cost models, cost model user manuals, and cost studies for new unbundled network elements (UNEs) that Qwest intends to offer through its Statement of Generally Available Terms and Conditions (SGAT). Qwest stated that the proposed prices in this case are for UNEs, products, and services that were not included in the Board's earlier wholesale cost proceeding, Docket No. RPU-96-9. Qwest witness Ms. Ione Wilkens offered Exhibit IEW-1, a comprehensive listing of elements, facilities, and services for which Qwest proposed rates in this docket. She also offered Exhibit IEW-2, a composite of the rates and services being proposed in this docket and the wholesale rates previously approved in Docket Nos. RPU-96-9 (Wholesale Costing) and RPU-00-1 (Deaveraged Wholesale Loop Rates).

On July 12, 2001, the Consumer Advocate filed an objection, a request for docketing, and an appearance. The Board issued an order on July 20, 2001, to docket the filing and establish the procedural schedule.

On August 2, 2001, Sprint Communications Company L.P. (Sprint) filed a petition for intervention. The Board issued an order granting the petition on August 14, 2001.

On August 16 and 17, 2001, AT&T Communications of the Midwest, Inc. (AT&T), and McLeodUSA Telecommunications Services, Inc. (McLeod), respectively, petitioned for intervention. McLeod filed a motion to expand the proceeding and modify the procedural schedule on August 28, 2001. In its motion, McLeod requested that the Board expand this docket to consider all UNE prices Qwest offers in Iowa, including those previously established by Board order in Docket No. RPU-96-9. The Consumer Advocate joined in McLeod's motion to expand the scope of the proceeding in a response filed August 29, 2001. On August 31, 2001, the Board issued an order granting intervention to McLeod and modifying the procedural schedule to permit consideration of McLeod's motion to expand.

Qwest resisted McLeod's motion to expand the proceeding on September 6, 2001. The Consumer Advocate and McLeod filed replies to Qwest's response on September 11, 2001. On September 19, 2001, the Board issued an order granting intervention to AT&T and denying the request to expand the scope of the proceeding because of the uncertainty regarding the legal status of the FCC's total element long run incremental cost (TELRIC) pricing rules.[3] McLeod filed a notice of withdrawal on September 20, 2001.

On September 21, 2001, AT&T filed testimony in the form of an affidavit and the Consumer Advocate filed direct testimony and public and confidential exhibits.

[3] The Board stated, "If the Board were to expand this proceeding to consider all of Qwest's UNEs, it is unclear what standards the Board would be required to apply to any new cost studies. The remand from the federal district court requires that the Board use the FCC's TELRIC methodology, but the recent Eighth Circuit decision vacates and remands the FCC's TELRIC rules. It appears it would be an inefficient use of the resources of the Board and the parties to conduct a full-scale UNE and wholesale cost review at this time, when the standards applicable to that review are uncertain." Furthermore, the Eighth Circuit decision is now pending before the United States Supreme Court in AT&T Corp. v. Iowa Utilities Board, Case No. 00-590.

Qwest filed supplemental direct testimony and exhibits on October 3, 2001, and supplemental exhibits on October 4, 2001. Qwest filed rebuttal testimony and a confidential exhibit on October 19, 2001. The Consumer Advocate filed rebuttal testimony and public and confidential exhibits on November 5, 2001. On November 7, 2001, Qwest filed a pre-hearing brief. On the same date, a joint statement of issues was filed by the Consumer Advocate, AT&T, and Qwest. On November 16, 2001, the Board issued an order modifying the procedural schedule. AT&T filed a motion for leave to withdraw on November 27, 2001.

The Board issued an order assigning this case to the Administrative Law Judge (ALJ) on November 28, 2001. The ALJ issued an order on December 3, 2001, granting AT&T's motion to withdraw. On December 6, 2001, Qwest filed corrections to testimony and exhibits. On December 11, 2001, the ALJ issued an order granting an oral motion to proceed without a hearing filed jointly by the Consumer Advocate and Qwest, and not objected to by Sprint. On December 12, 2001, the Consumer Advocate and Qwest filed a joint motion to cancel the hearing set for December 13, 2001.

The ALJ issued an order on December 20, 2001, with questions for the parties. An order was also issued on January 3, 2002, accepting McLeod's withdrawal. On January 9, 2002, Qwest and the Consumer Advocate filed responses to the questions posed by the ALJ.

On January 16, 2002, the ALJ issued an order notifying the parties there would be no additional questions. The Consumer Advocate and Qwest filed initial briefs on February 6, 2002, and reply briefs on February 20, 2002. Qwest filed a motion for leave to file a surreply, with the surreply brief attached, on March 5, 2002.

COSTING AND PRICING PRINCIPLES

Iowa law requires incumbent local exchange carriers (ILECs) such as Qwest to provide access to unbundled essential facilities on terms and conditions that are reasonable, nondiscriminatory, cost-based, and tariffed. Iowa Code § 476.101(4)(a)(1) (2001). Federal law requires that ILECs provide interconnection and access to unbundled network elements (UNEs) on "rates, terms, and conditions that are just, reasonable, and nondiscriminatory." 47 U.S.C. § 251(c)(2) and (c)(3); 47 C.F.R. § 51.307. Federal law also requires that determinations by state commissions of the just and reasonable rate for interconnection and network elements must be "based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the . . . network element," nondiscriminatory, and "may include a reasonable profit." 47 U.S.C. § 252(d)(1).

Furthermore, when the Board makes decisions regarding regulation of telephone companies, it must "consider the effects of its decisions on competition in telecommunications markets and, to the extent reasonable and lawful, shall act to further the development of competition in those markets." Iowa Code § 476.95(2). The Board is to promote competition, not to favor one competitor over another.

Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, 11 FCC Rcd 15499, ¶ 618 (rel. Aug. 8, 1996) (FCC First Report and Order).

In its Line Sharing Order,[4] released on December 9, 1999, the FCC adopted a requirement that ILECs unbundle the high frequency portion of the local loop and offer it to CLECS as an unbundled network element (UNE). 47 C.F.R. § 51.319(h). The FCC also established guidelines to assist states in applying the FCC UNE pricing rules to line sharing. Line Sharing Order, ¶¶ 132 - 157. As the FCC stated, "Even if line sharing is made available to competitive LECs, however, it will not promote competition unless it is priced in a way that permits competitive LECs to enjoy the same economies of scale and scope as the incumbent LECs." Line Sharing Order, ¶ 133. In setting prices in this case, we must consider the effect on competition of the aggregate of the price for the HFPL, the OSS line sharing modification price, and the prices for the other UNEs the CLECs must have to interconnect with Qwest's facilities. Iowa Code § 476.95(2) (2001); Line Sharing Order, ¶ 133.

[4] *In the Matters of Deployment of Wireline Services Offering Advanced Telecommunications Capability and Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 98-147, Third Report and Order, CC Docket No. 96-98, Fourth Report and Order, 14 FCC Rcd. 20,912 (Line Sharing Order).

PRICE FOR THE HIGH FREQUENCY PART OF THE LOOP (HFPL)[5]

Qwest's Position

Qwest proposes a recurring, monthly charge of $5, and a nonrecurring charge of $38.62 per loop for each shared loop, for the HFPL. (Brohl Direct p. 4; Exhibit IEW-1) Ms. Brohl testified that $5 is a reasonable price because Qwest has a productive asset that CLECs and DLECs would use to provide a service, Qwest's experience in negotiating with carriers is that they agree Qwest should receive some compensation for that productive asset, and the price passes the FCC's criteria and is lawful. (Brohl Direct p. 4)

In response to staff question number two,[6] Qwest outlines the key points of its rationale for choosing a $5 price for the HFPL. Qwest's rationale starts with the recognition that on a shared line, the cost of the loop is a joint cost. The customer receives two dedicated connections over a shared line (one over the HFPL, and one over the low frequency part of the loop), and together, these connections cause the cost of the loop.[7] There is no significant change to the underlying cost of the loop when two dedicated connections are offered on a single loop.[8] Qwest contends that a cost-based price for use of the HFPL should include recovery of a portion of the

[5] The HFPL is sometimes referred to as the high frequency unbundled network element, or HUNE. The terms are interchangeable.
[6] *Order Issuing Questions to Parties* (December 20, 2001).
[7] Qwest's answers to *Order Issuing Questions to Parties*, p. 2.
[8] Fitzsimmons, Direct p. 7.

joint and common costs of the loop. Qwest's position is that TELRIC[9] does not offer a meaningful basis for selecting the most reasonable allocation of this joint cost. Qwest states there is no single "correct" allocation of joint and common costs, and the price of the HFPL should recover a portion of the loop cost.[10]

Qwest believes the key question for pricing the HFPL is whether the price is consistent with the competitive solution and furthers the goals for pricing unbundled elements, given the cost of the unbundled loop.[11] Qwest states the answer to this question is that the price should be based on the most reasonable allocation of the joint loop cost, and that a zero or near zero allocation of joint and common costs is not the most reasonable allocation.[12] Qwest's position is that a price of zero or near zero for the HFPL will not allow the competitive process to sort out the true competitive price and will discriminate against facilities-based competition.[13]

Qwest reasons that it has negotiated interconnection agreements with competitive carriers that include a $5 price for the HFPL, and therefore, this is an indication of a reasonable allocation of joint loop costs.[14]

Qwest believes that the initial price set by the Board will act as a price ceiling and feels there is no meaningful evidence that the market price is below $5. Qwest

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[9] The FCC adopted the TELRIC methodology as the basis for setting prices for interconnection and UNEs pursuant to 47 U.S.C §§ 251(c)(2), 251(c)(3), and 252(d)(1) in the FCC First Report and Order ¶ 672. As discussed above, the legal status of this methodology is currently on appeal to the U.S. Supreme Court.
[10] Qwest’s responses to *Order Issuing Questions to Parties*, pp. 2-3; Fitzsimmons Direct pp. 4 - 8.
[11] Qwest's response to *Order Issuing Questions to Parties,* p. 2; Fitzsimmons Direct p. 12.
[12] *Id.*
[13] *Id.* at p. 3; Fitzsimmons Direct pp. 12, 18.
[14] *Id.* at pp. 3-4; Fitzsimmons Rebuttal p. 28.

states that setting the price below $5 will preclude the competitive market from deciding the actual market price.[15]

Consumer Advocate's Position

Dr. Carl Hunt testifies he is in substantial agreement with Dr. Fitzsimmons that line sharing involves joint and common costs. He also testifies that Qwest applied no discernible costing and price method to establish its proposed price for the HFPL. He testifies that Qwest "intuited" that a $5 rate was appropriate but provided no cost studies to support the rate.[16] Dr. Hunt testifies that TELRIC methods could be used to estimate the incremental costs of the HFPL, and that use of TELRIC as a costing method would result in a zero cost for the use of the HFPL.[17]

Dr. Hunt testifies that although Dr. Fitzsimmons is correct that there is no single correct allocation of joint or common costs, all allocation methods are not equally valid, and the intuitive method used by Qwest is not reasonable.[18]

Dr. Hunt presents three methods of allocating the joint and common costs of the loop to arrive at a price for the HFPL: the joint-products method, the modified proportional method, and the proportional method. Dr. Hunt believes the joint-products method and the modified proportional method, respectively, are the more accurate of the three methods, but they require additional data and other criteria not

[15] *Id.* at p. 4.
[16] Hunt Direct, pp. 5, 7-8.
[17] Hunt Direct, pp. 6-7.
[18] Hunt Direct, p. 8.

available in this docket. Dr. Hunt, therefore, uses the proportional method to allocate joint and common costs to the HFPL.[19]

In making the allocation, Dr. Hunt uses the statewide average local loop UNE cost of $20.15, the price set in Docket No. RPU-96-9.[20] He does not recommend that the HFPL rate be deaveraged.[21] To allocate the joint and common costs of the loop, Dr. Hunt chose six broad service/UNE categories that cannot be provided without the local loop: interstate toll, basic exchange service, intrastate toll, class and features services, operator services, and the HFPL.[22] Dr. Hunt believes the proportional method becomes problematic if services are disaggregated below broad service categories.[23]

Dr. Hunt allocates 25 percent of the total loop cost to interstate toll. This is the amount currently assigned to interstate toll through separations. The remaining five categories are assigned 15 percent each.[24] This allocation method results in a monthly recurring price for the HFPL of $3.02.[25] Dr. Hunt considers this price for the HFPL to be at the high end of the just and reasonable scale.[26] The Consumer Advocate did not discuss or dispute the proposed nonrecurring $38.62 price for the HFPL contained in Exhibit IEW-1.

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[19] Hunt Direct, pp. 9-17.
[20] Hunt Direct, p. 17.
[21] Hunt's responses to *Order Issuing Questions to Parties*, p. 6.
[22] Hunt Direct, p. 17.
[23] Hunt's responses to *Order Issuing Questions to Parties,* p. 3.
[24] Hunt's responses to *Order Issuing Questions to Parties,* pp. 2-4.
[25] Hunt Direct, p. 17; Exhibit CEH-5.
[26] Hunt’s responses to *Order Issuing Questions to Parties*, p. 6.

Analysis

In determining the price to be set for the HFPL, it is important to remember that there is no incremental cost to Qwest for the HFPL itself.[27] There are incremental costs related to providing line sharing, but those are not for the HFPL itself. All of Qwest's incremental costs related to providing line sharing will be fully recovered by Qwest through the nonrecurring $38.62 price, the price for OSS modification due to line sharing, and the prices set for the other collocation UNEs and services. The only issue here is whether any portion of the joint and common costs of the loop should be allocated to the HFPL. Although both Qwest and the Consumer Advocate argue that some allocation should be made and a positive price for the HFPL be set, the arguments are not persuasive for the following reasons.

First, both state and federal law require that prices be cost-based. Neither Qwest's proposal of $5, nor the Consumer Advocate's proposal of $3.02, is cost-based. Both proposals are based on different economic theories. There are no cost studies or other cost-based evidence to support them. There are no incremental costs for the HFPL itself, and Dr. Hunt testified if TELRIC methodology were applied, the price would be $0.[28]

In its Line Sharing Order, the FCC established guidelines for states to use when applying the UNE pricing rules to line sharing. Line Sharing Order ¶ 132. The FCC recognized that pricing the HFPL is different from pricing other UNEs and

[27] Hunt Direct, pp. 6-7; Fitzsimmons Direct, pp. 4-8, 13; Qwest Responses to Questions, pp. 2-3.
[28] Id.

services in the Line Sharing Order, and stated: "We are thus presented with the question of how to establish the forward looking economic cost of unbundled bandwidth on a transmission facility when the full embedded cost of that facility is already being recovered through charges for jurisdictional services." Line Sharing Order, ¶ 138. The FCC concluded that states may require ILECs to charge "no more to competitive LECs for access to shared local loops than the amount of loop costs the incumbent LEC allocated to ADSL services when it established its interstate retail rates for those services." *Id. at* ¶ 139. Under this analysis, the price to be set for the HFPL would be $0, because Qwest stated it did not allocate a portion of the shared or common loop costs to xDSL services when setting its interstate retail rates for those services.[29]

The FCC also stated: "Currently, incumbent LECs are recovering the full embedded cost of their loops through revenues received from intrastate business and residential voice services, interstate access charges, and intrastate access charges. Nothing we do today affects the ability of incumbent LECs to continue to receive revenues from those services. Furthermore, the TELRIC methodology allows states to include in the price of an unbundled network element a reasonable allocation of forward-looking common costs. We anticipate, therefore, that states will set interim or arbitrated prices for line sharing to include forward-looking common costs." Line Sharing Order, ¶ 152. Qwest proposes to recover an allocation of joint and common costs in its $5 proposed price. However, Qwest is already fully compensated for its

[29] Qwest responses to *Order Issuing Questions to Parties*, p. 5.

joint and common costs in the prices for the loop, switching, and transport that were set in Docket No. RPU-96-9. *Final Decision and Order,* Docket No. RPU-96-9, issued April 23, 1998, pp. 15, 25-26. As the Board stated in that decision, "No additional shared and common cost recovery is needed from the other unbundled network elements." *Id.* ILECs may not recover the same common costs multiple times from different elements, because any such recovery would be unreasonable and thus in violation of the statutory standard. FCC First Report and Order, ¶ 698.

Qwest's argument that the $5 price for the HFPL it negotiated with several Iowa competitors indicates that $5 is a reasonable allocation of joint loop costs to the HFPL is not persuasive. As the FCC stated: "Congress recognized that, because of the incumbent LEC's incentives and superior bargaining power, its negotiations with new entrants over the terms of such agreements would be quite different from typical commercial negotiations. As distinct from bilateral commercial negotiation, the new entrant comes to the table with little or nothing the incumbent LEC needs or wants." First Report and Order, ¶ 15. Furthermore, as Dr. Hunt testified, a rate based on a competitor's willingness to pay is not cost-based, and therefore is inconsistent with the Telecommunications Act.[30]

The price set for the HFPL must be reasonable. Although it might seem reasonable to set a positive price for the HFPL because CLECs will receive the

[30] *Id.*

benefit of using this productive asset, the FCC rejected such an analysis in the Line Sharing Order at ¶ 157. The FCC stated it rejected U S WEST's[31] value-based pricing methodology, because the price for UNEs should be based on forward-looking costs, and setting the price based on the competitive value that the facility confers upon another party does not conform with the pricing principles set forth in the Line Sharing Order and the FCC First Report and Order. *Id.*

In a future rate case, when all the UNEs and services, including the loop, can be considered together, the Board may decide it would be reasonable to allocate a portion of the joint and common costs to the HFPL. This could be done when the HFPL is considered together with the other UNEs and services so that there is some assurance that each bears its fair share of the joint and common costs and there is appropriate recovery for each UNE. However, when the HFPL is considered separately from the loop and other UNEs and services, it is unreasonable, and not in conformance with the cost-based requirements of state and federal law, to set a positive price for the HFPL. Qwest is already fully compensated for both the incremental and joint and common costs associated with line sharing.

For all of the above reasons, the monthly, recurring charge for the HFPL should be set at zero. Qwest's proposed nonrecurring charge of $38.62 per loop for each shared loop for the HFPL is uncontested, and will be approved subject to complaint or investigation.

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[31] U S WEST Communications, Inc., a predecessor of Qwest.

RECOVERY OF OSS MODIFICATION COSTS

Qwest's Position

Qwest argues it is legally entitled to recover the costs it incurred for modifications to OSS to provide for line sharing, and proposes a recurring monthly rate of $3.41 for each line that is shared with a CLEC.[32] Qwest argues its use of a recurring charge to recover these nonrecurring OSS costs is supported by the FCC's Line Sharing Order, ¶ 144, which states:[33]

> We find that incumbent LECs should recover in their line sharing charges those reasonable incremental costs of OSS modification that are caused by the obligation to provide line sharing as an unbundled network element. We believe that this guidance is consistent with the principle set forth in the *Local Competition First Report and Order* that incumbent LECs cannot recover nonrecurring costs twice. We also reaffirm the conclusions in the *Local Competition First Report and Order*, that the states may require incumbent LECs in an arbitrated agreement to recover such nonrecurring costs such as these incremental OSS modification costs through recurring charges over a reasonable period of time; and that nonrecurring charges must be imposed in an equitable manner among entrants.

Qwest identifies three components of the costs for OSS modifications it is proposing to recover. The first is a charge of $11.9 million from Telcordia. This charge is for the work performed by Telcordia (source code modifications, for example)

[32] Qwest Pre-Hearing Brief, pp.12-13; Brigham Direct, pp. 47-49.
[33] Brigham Direct, p. 49; Qwest Post Hearing Brief, p. 26.

to the software Telcordia owns and Qwest uses.[34] The second component is $870,720 for modifications to the OSS for which Qwest maintains the system source code. This work was performed by Qwest. The final component is $56,000 for project management. Qwest is seeking cost recovery for a total of $12,826,720 for OSS modifications attributable to line sharing.[35]

Qwest rejects Dr. Hunt's challenge to the appropriateness of the $11.9 million charge from Telcordia. It argues that even though Telcordia's charge is market-based, it is not invalid. Qwest argues that the price it pays to vendors are Qwest's costs, regardless of how that price was established. It argues when Qwest purchases cable or switches, the vendor price is market-based, and the costs for purchasing software should not be treated differently from the costs for cable or switches. Qwest contends the relevant issue is whether Qwest's OSS line sharing charge is cost-based, not whether the vendor price is cost-based.[36]

In its Post-Hearing Brief, Qwest asserts that Dr. Hunt's argument that Qwest improperly relied on the market-based rate it paid to Telcordia for OSS modifications has no validity. Qwest argues that the FCC requires that rates for UNEs reflect the rates that would exist in a competitive market, and consistent with this principle, it is appropriate to set a rate based on the actual market-based costs Qwest has incurred.

[34] Telcordia actually billed Qwest $14 million for OSS modifications not specific to line sharing along with the line sharing OSS modifications. Telcordia later determined that 85 percent of the modifications were related to line sharing, and that is how Qwest arrived at the $11.9 million figure. Qwest Answers to Questions, pp. 13-15; Qwest Exhibit 5; OCA Confidential Exhibit CEH-19.
[35] Albersheim Direct, p. 22; Brigham Direct p. 47.
[36] Brigham Rebuttal, pp. 5-6.

Qwest argues that Dr. Hunt's recommendation results in a rate that is neither cost-based nor reflective of conditions in a competitive market.[37]

Qwest also disagrees with Dr. Hunt's contention that Telcordia's market-based charge to Qwest was inflated and the result of a monopolistic charge. Qwest argues that Dr. Hunt's testimony incorrectly implied that the Washington State Utilities and Transportation Commission (WUTC) found that Verizon implemented the same line sharing OSS functionality as Qwest at one-tenth the cost. Qwest argues this statement does not reflect the conclusions of the WUTC, because Verizon had not sought recovery for OSS modifications specific to line sharing. [38]

Qwest further argues that the Consumer Advocate's recommendation to reduce the $11.9 million by 50 percent is based on nothing but vague suggestions about the relationship between Qwest and Telcordia. Qwest argues the most glaring error in the Consumer Advocate's analysis is the assertion that Qwest has not offered evidence validating the amounts paid to Telcordia. Qwest contends this assertion ignores the "Statement of Work" provided with the direct testimony of Qwest witness Albersheim, which, it argues, is a detailed description of the OSS work that Telcordia was required to perform to complete the modifications.[39]

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[37] Brigham Rebuttal, pp. 5-6; Qwest Post-Hearing Brief, p. 27.
[38] Curtis Rebuttal, pp. 3-4.
[39] Qwest Reply Brief, p .7; Albersheim Direct, pp. 19-20; Qwest Exhibit RA-3.

Qwest further argues that the Consumer Advocate offers no evidence to substantiate its proposal to reduce the $11.9 million by $6 million. Qwest argues this recommendation is completely arbitrary.[40]

Qwest rejects Dr. Hunt's claim that it benefits from OSS modifications to support line sharing because line sharing lets Qwest retain voice service to the customer. Qwest witness Mr. Curtis argues that whether Qwest benefits or not from OSS modifications is irrelevant, because Qwest is allowed to recover its cost. Qwest's voice service is independent of any data service. Qwest argues that Dr. Hunt's implication the OSS modifications preclude an end-user from changing voice providers to a different carrier when a data local exchange carrier (DLEC) shares the loop over which Qwest provides voice service is incorrect.[41]

Mr. Curtis testified the modifications to OSS were made to comply with the FCC mandate, and to create the ability to record, inventory, maintain, repair, and bill for multiple carriers on the same loop. He argues that Qwest has no need for the additional software and it does nothing to help Qwest with its voice service business. He testified that Dr. Hunt's conclusion that Qwest shares the benefit of line sharing and should share the costs 50/50 is incorrect.[42]

Qwest proposes to recover its OSS modification costs for line sharing through a recurring monthly rate of $3.41 for each line that is shared with a CLEC or DLEC. In

[40] Id., pp. 7-8; Curtis Rebuttal, p. 11.
[41] Rebuttal, Curtis, pp. 8-10.
[42] Id., pp. 10-11; Qwest Post-Hearing Brief, pp. 4, 28-29.

calculating the $3.41 charge, Qwest applied the costs it incurred to an estimated demand level for line sharing and assumed a five-year recovery period. Qwest chose a five-year recovery period because, it argues, the technology changes rapidly and Qwest cannot envision a useful life for a given technology extending beyond five years. Qwest states it used the best available data in estimating the demand for line sharing. Projections were developed for the first two years and trends were estimated from this information for five years. Qwest indicated it would consider alternative inputs from CLECs who are willing to provide them.[43]

Qwest disagrees with Dr. Hunt's position that the recovery period for OSS modification costs should be 10 or 15 years. Qwest agrees with Dr. Hunt's assumption that the loop will last longer than five years, but disagrees that line sharing will last longer than five years. Qwest views line sharing as an interim solution, arguing that the bandwidth capacities with digital subscriber line (DSL) are limited, and customers in the future will require bandwidth in excess of what is available with current DSL technology. Qwest believes the demand for service with these current limits will be attractive for only a few more years.[44] Qwest also contends that the Consumer Advocate has offered no evidence supporting the conclusion that line sharing will last for 10 to 15 years, and has not identified what new technologies will supposedly extend the life of line sharing.[45]

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[43] Brigham Direct, pp. 49-51.
[44] Brigham Rebuttal, pp. 7-8.
[45] Brigham Rebuttal, p. 8; Reply Brief, pp. 10-11.

Qwest also rejects Dr. Hunt's criticism that Qwest did not apply a statistical analysis in its estimate of demand for line sharing. Qwest claims it is unable to determine the level of DSL service to be provisioned via line sharing without receiving demand estimates from the CLECs and DLECs. Qwest indicated it has requested this information, but it has been scarce. As a result, Qwest has made its best effort to estimate the demand for line sharing.[46]

Qwest contends the application of a levelizing factor with a discount rate is appropriate. It argues the application of a discount factor is a common method of levelizing periodic payments of unequal amounts. Qwest contends its levelizing methodology produces exactly the level of revenue that is needed to fully recover its costs, and that the use of the Consumer Advocate's average demand will result in a cost recovery shortfall of almost $1 million.[47]

Qwest disagrees with Dr. Hunt's statement that the OSS study should use the 2005 demand estimate. Qwest argues its demand forecast is reasonable and TELRIC does not require the use of 2005 estimates in 2001 and 2002. Qwest argues that use of Dr. Hunt's recommendation could prevent Qwest from recovering its costs.[48] Qwest contends its forecast is a reasonable estimate of demand.[49]

Qwest disagrees with the Consumer Advocate's proposal that recovery of the line sharing OSS expenses should be calculated using a monthly payment mode

[46] Brigham Rebuttal, pp. 8-9.
[47] Brigham Rebuttal, pp. 10-11.
[48] Brigham Rebuttal, p. 11.
[49] Brigham Rebuttal, p. 9; Qwest Reply Brief, p.12.

instead of an annual payment mode. Qwest contends the annual payment mode is a common, industry-accepted methodology for calculating this type of cost recovery. Qwest's rationale for using an annual payment mode is that it eliminates or minimizes the effect of uneven or unequal periodic payments. This method averages periods of highs and lows over a 12-month period, including costs that are not incurred on a monthly basis. This approach captures all relevant costs but spreads them evenly throughout the year. Qwest contends the Consumer Advocate has not offered an explanation as to why the monthly payment mode yields a more consistent or fair result, nor has it explained why Qwest should be forced to depart from a widely accepted annual payment methodology.[50]

Qwest further argues its price for its interstate DSL select service would pass an imputation test that included both a $5 HFPL charge and a $3.41 OSS recovery charge, and that Dr. Hunt's imputation analysis is flawed.[51]

The Consumer Advocate's Position

The Consumer Advocate agrees that some level of cost recovery for OSS modifications should be allowed, but that the evidentiary record lacks any objective standard for determining the extent to which recovery should be allowed. The Consumer Advocate contends Qwest should not be allowed to recover all of the $11.9 million Telcordia charge. It contends the method used by Qwest to calculate its proposed monthly charge is flawed in several respects. Dr. Hunt testified Qwest

[50] Qwest Reply Brief, pp. 9-10.
[51] Brigham Rebuttal, pp. 12-14.

has miscalculated the demand for the HFPL, used an annual payment mode to compute monthly payments, applied an average demand schedule to a forward-looking methodology, and amortized the expenses over an unreasonably short life span.[52] The Consumer Advocate recommends the Board reject Qwest's proposed $3.41 rate for OSS modifications and adopt a rate in the range of $0.45 to $0.59.[53]

The Consumer Advocate contends that only one-half of the $11.9 million charge from Telcordia should be recovered from HFPL customers.[54] According to Dr. Hunt, Qwest admitted the price paid to Telcordia for OSS modifications was market-based and not cost-based. Dr. Hunt contends that Qwest overpaid Telcordia either because of Telcordia's inefficiencies or due to Telcordia's market power with respect to Qwest.[55] The Consumer Advocate asked Qwest to provide a detailed explanation of how Telcordia determined that 85 percent of the cost of modifications were attributable to line sharing. Qwest's response was essentially that Telcordia made that determination. The Consumer Advocate contends that no evidence has been presented which reflects that Telcordia's charges are just and reasonable.[56]

Dr. Hunt testified that before being purchased by Science Applications International Corporation (SAIC), Telcordia was known as Bellcore. Bellcore was owned by U S WEST, in partnership with the other regional Bell operating companies

[52] Hunt Direct, pp. 36-37.
[53] Consumer Advocate Initial Brief, p. 6.
[54] Hunt Direct, pp. 25-26.
[55] Hunt Direct, p. 20.
[56] Hunt Rebuttal, pp. 16-17.

(RBOCs). U S WEST and the other RBOCs divested themselves of Bellcore for strategic reasons. When they sold Bellcore, they gave up proprietary rights to many software systems, including software essential to Qwest's OSS. Qwest was compensated by SAIC for granting these exclusive rights to the software. Dr. Hunt suggests the transfer of these exclusive proprietary rights to Telcordia created the potential for Telcordia to overcharge Qwest for future OSS software modifications.[57]

The Consumer Advocate argues that Qwest witness Ms. Brohl acknowledged in WUTC Docket No. UT-0030013 that Qwest did not take steps to ensure that it was not paying for a software upgrade that Telcordia had already been paid to do by another ILEC.[58] Ms. Brohl also acknowledged that Qwest's dealing with Telcordia are not cost-based, leading the WUTC to find that "Qwest's costs are clearly not cost-based and . . . are not just and reasonable."[59] The Consumer Advocate argues that Qwest's concept of "cost" simply ignores the statutory "just and reasonable" requirement. The Consumer Advocate further argues that Qwest should not be allowed to recover regulated expenses simply upon presentation of an invoice.[60]

The Consumer Advocate argues there is nothing in the evidentiary record that suggests the Telcordia charges are cost-based. Qwest is a captive customer of Telcordia and the $11.9 million charge was based on Telcordia's estimation of what the market would bear, not on an objective assessment of costs to perform the

[57] Hunt Direct, p. 21.
[58] Consumer Advocate Reply Brief, p. 7; Exhibit CEH-22, pp 25-26.
[59] Id.
[60] Consumer Advocate Reply Brief, p. 7.

work.[61] According to Dr. Hunt, Qwest did not put the OSS modifications out for bid but relied on a sole-source contract with Telcordia. He asserts that Qwest claimed it had no choice due to Telcordia's exclusive proprietary rights to the OSS software. Apparently, Telcordia is the only entity that can make changes to the software and Qwest is a captive customer. Dr. Hunt believes this means OSS modifications are no longer cost-based; that the situation allows Telcordia to maximize its profits through its monopoly power with respect to OSS modifications. As a result, Dr. Hunt believes the $11.9 million payment to Telcordia cannot be considered just, reasonable, or prudent and that ratepayers, be they end-users or CLECs and DLECs, should not have to pay for inflated, passed-through, costs. [62]

The Consumer Advocate contends the WUTC found that the relationship between Telcordia and Qwest was one of the reasons Qwest's OSS costs were so high when compared to those of Verizon, and adjusted Qwest's OSS costs to be in line with Verizon's.[63] Dr. Hunt testified that Qwest, involved in the first UNE docket in Oregon, should have been aware of the "competition juggernaut" driving the industry and taken steps to accommodate the inclusion of a competitive market. Dr. Hunt views this lack of flexibility as less than prudent or as a barrier to entry and in either case, does not believe customers should pay.[64]

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[61] Consumer Advocate Initial Brief, p. 7.
[62] Hunt Direct, pp. 21-23.
[63] Hunt Rebuttal, pp. 13-15.
[64] Hunt Direct, pp. 23-24.

Dr. Hunt admits it is difficult to place a monetary value on Qwest's failure to anticipate a competitive market. He suggests the Board keep Qwest's failure to adequately prepare for competition in mind when making its decision in this docket.[65]

Dr. Hunt testified that Qwest benefits from the development of OSS for line sharing by retaining the voice customer and not losing it to the CLEC or DLEC. He goes on to say that Qwest does not have a "right" to any customer in a competitive environment. Without the OSS modification that allows access to the HFPL, a customer wanting to purchase DSL from a CLEC or DLEC would have to buy voice, Internet service provision (ISP), and DSL from the CLEC or DLEC, and Qwest would lose the voice customer. Besides the benefit of retaining the voice customer with line sharing, Dr. Hunt points out that Qwest also benefits from being able to sell the HFPL. Since the OSS modification benefits both the CLEC or DLEC and Qwest, the cost of the OSS modification should be shared by both.[66] Due to the relationship between Telcordia and Qwest that led to an unreasonably high price for OSS modification, and to the benefit Qwest receives, the Consumer Advocate argues that Qwest should only be allowed to recover one-half of the $11.9 million paid to Telcordia.[67]

The Consumer Advocate disagrees with Qwest's method of calculating the monthly charge for recovering the OSS expenses using an annual payment mode.

[65] *Id*., p. 24.
[66] *Id*., pp. 24-26.
[67] Hunt Direct, pp. 25-26; Hunt Rebuttal, pp. 14-15; Consumer Advocate Initial Brief, p. 8.

Dr. Hunt contends that a monthly payment mode is more appropriate because the DLECs will be making monthly payments.[68]

The Consumer Advocate also disagrees with Qwest's proposed recovery period of five years. Dr. Hunt argues these costs should be recovered over the expected life of line sharing. The assumption of a five-year life is based on the assertion that five years represents the life of the technology. However, Qwest has provided no evidence supporting this assertion. The Consumer Advocate contends that line sharing is not based on a specific technology, but rather a concept that utilizes technology. Line sharing includes the concept of a competitive telecommunications market and the joint use of existing facilities. The concept of line sharing, competition, and existing facilities will last longer than five years. These costs should be amortized over a period equal to the life of the concept of line sharing and competition. Dr. Hunt argues that a more reasonable period for the projected life of line sharing is 10 to 15 years.[69]

Dr. Hunt takes issue with the application of a discount rate to demand quantities. He argues that Qwest's application of a levelizing factor understates demand and inflates the OSS modification charge. He testified that Qwest's levelizing methodology understates demand by 8 percent and should be corrected by using the actual non-discounted demand forecasted estimates.[70]

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[68] Hunt Direct, pp. 26, 36.
[69] Hunt Direct, pp. 26-28, 36; Hunt Rebuttal, pp. 19-20; Consumer Advocate Initial Brief, pp. 8-9.
[70] Hunt Direct, pp. 29-30.

The Consumer Advocate contends that the TELRIC components of the OSS charge should be calculated using a forward-looking demand estimate instead of the averaged demand estimate. It argues that TELRIC is a forward-looking costing methodology and it would be more appropriate to use a forward-looking demand estimate. Revenues and costs are not averaged over the five-year period; they are specific to the fifth year. The Consumer Advocate contends a basic tenet in costing is to match costs, revenues, and other relevant items to the same time period. Therefore, it argues, it is appropriate to use the demand associated with the time period in use, and the OSS charge should be calculated using the year 2005 demand projection.[71]

The Consumer Advocate argues that Qwest's TELRIC "add on" of 28.5 percent for common overhead costs seem inappropriately high and possibly results in double recovery due to Qwest also recovering $56,000 in project management costs for the OSS modification.[72] It contends that if the Board considers a TELRIC "add on" to be appropriate, then the TELRIC demand level should be used in conjunction with the TELRIC costs.[73]

Dr. Hunt states that in estimating future demand, Qwest did not employ any statistical analysis or other empirical estimate of demand but, rather, used an intuitive method. However, he testified that given the difficulties of estimating such demand,

[71] Consumer Advocate Initial Brief, pp. 9-10.
[72] Hunt Direct, p. 33.
[73] Hunt Direct, p. 33.

the intuitive method may work as well as any other. He testified Qwest under-estimated demand considering the number of Qwest lines, the number of Qwest DSL customers, and the number of ISPs providing service to Qwest customers, but believes the Board should accept Qwest's demand estimates unless a more persuasive demand study is presented.[74]

The Consumer Advocate recommends a recurring, monthly rate of between $0.45 and $0.59 for recovery of Qwest's OSS line sharing modification costs.[75]

Analysis

In its Line Sharing Order at ¶ 144, the FCC found that ILECs "should recover in their line sharing charges those reasonable incremental costs of OSS modification that are caused by the obligation to provide line sharing as an unbundled network element." The FCC found this guideline to be consistent with the principle set forth in the FCC First Report and Order that ILECs cannot recover nonrecurring costs twice. It also reaffirmed that states may require ILECs to recover such nonrecurring costs as these incremental OSS modification costs through recurring charges over a reasonable period of time, and that nonrecurring charges must be imposed in an equitable manner among entrants. Line Sharing Order at ¶ 144.

While both parties agree that Qwest should recover some amount for OSS modification costs, they disagree on the total amount to be recovered and how the monthly recurring rate should be calculated. With regard to the amount to be

[74] *Id*., pp. 28-29.
[75] OCA Initial Brief, p. 6.

recovered, Qwest argues for recovery of the entire amount it paid Telcordia[76] ($11.9 million), an additional $870,720 for modifications to the OSS for which Qwest maintains the system source codes, and $56,000 for project management cost. The total amount Qwest seeks to recover is $12,826,720.[77] The Consumer Advocate supports a recovery amount of $6,878,720.[78] The Consumer Advocate derived this amount by reducing the $11.9 million by 50 percent to obtain $5.95 million, and adding this to the $870,720 and $56,000. The dispute on the appropriate total to recover focuses on the $11.9 million payment to Telcordia.

Qwest did not present any evidence in this case that proves the reasonableness of the $11.9 million it paid to Telcordia. Qwest merely presented the lump sum it was billed by Telcordia and Telcordia's unsupported statement that 85 percent of the work was attributable to line sharing. The evidence it presented regarding how Telcordia attributed 85 percent of the fee to line sharing is completely inadequate. Qwest did not relate the amount paid to Telcordia to actual work performed. It is unclear from the record what specific, actual work Telcordia performed for Qwest and how that relates to the amount billed. It is completely unclear what work was done that relates to line sharing, and what work was done that was not related to line sharing. The testimony and exhibits of Ms. Albersheim do not show what work Telcordia actually performed. They do not relate to either the

[76] Actually, the 85 percent attributed by Telcordia to line sharing modifications.
[77] Albersheim Direct, p. 22.
[78] OCA Initial Brief, p. 10; Hunt Direct, p. 33.

$14 million billed by Telcordia or the $11.9 million attributed by Telcordia to line sharing. Although specifically asked to provide a more detailed explanation of the Telcordia charge and how it related to the work performed by Telcordia, Qwest did not do so, and it appears it is unable to do so because Telcordia refused to provide detailed explanations and claimed that the information was proprietary.

Qwest is a regulated company with respect to much of its operations, including the amount to be recovered for OSS modifications required to support line sharing. Qwest cannot shield itself from the requirement to provide sufficient supporting data to prove the reasonableness of the amounts proposed to be recovered by selling its OSS software to a separate, unregulated company, which then is the only entity Qwest can turn to when the software must be modified.[79] It would be reasonable for the Board to find that until Qwest provides sufficient supporting data, it cannot recover any of the amount charged by Telcordia.

Qwest is being held hostage by a foreseeable situation it created. As the Washington Commission found: "The sale of Bellcore compensated U S WEST and the other RBOCs for whatever exclusivity is associated with the ongoing proprietary

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[79] "Telcordia (formerly Bellcore) was owned by U S WEST (prior to its merger with Qwest) and the other regional Bell operating companies ('RBOCs'). U S WEST and the other RBOCs sold Telcordia to its current owners in 1997 along with proprietary rights to many of the software systems that are integral to Qwest's operations support systems. Because Telcordia is the owner of the software, Qwest must rely on this one vendor to modify operations support systems as long as Qwest retains the existing systems. Because Qwest is unable to solicit bids from competing vendors, Qwest is a captive customer of a single vendor. Telcordia's prices are no longer based on the cost of producing the software; rather, Telcordia's prices are based on Telcordia's ability to maximize its own profits." *Thirteenth Supplemental Order; Part A Order Determining Prices for Line Sharing, Operations Support Systems, and Collocation;* Docket No. UT-003013, Washington Utilities and Transportation Commission, p. 50 (Washington Line Sharing Order).

ownership of those pre-existing assets, including software essential to Qwest's operations support systems. The likelihood that modifications to software essential to U S WEST's OSS would be necessary was foreseeable at the time of the sale transaction. U S WEST set its sale price in consideration of its future reliance on an outside contractor." Washington Line Sharing Order, p. 52.

The WUTC found that Qwest's OSS costs were not cost-based and that they were not just and reasonable. Washington Line Sharing Order, p. 52. The Commission compared proposed rates filed by another ILEC in the state, Verizon, with those filed by Qwest, and found that Qwest's proposed rates were as much as ten times higher than Verizon's for the same functionality. Therefore, the Commission held that Qwest's proposal failed the just and reasonable standard of § 252(d)(1) of the Telecommunications Act and ordered Qwest to recover for OSS modification costs at the same rate as Verizon.[80] Washington Line Sharing Order, p. 53.

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[80] It should be noted that Verizon did not propose a separate OSS charge with respect to line sharing, while Qwest did. The OSS charge ordered in the case applied to the HFPL as well as for all other UNEs. The Commission found that Qwest's proposal to initiate a separate HUNE OSS charge was unreasonable, anti-competitive, and contrary to § 706 of the Telecommunications Act, which requires commissions to encourage the deployment of advanced telecommunications capability. The Commission held that for the purpose of OSS cost recovery, the HFPL would be treated in the same manner as all other UNEs requested by CLECs. Washington Line Sharing Order, p. 58. The Commission subsequently established a separate proceeding to receive additional evidence regarding Qwest's total OSS transition costs for line sharing, and ordered Verizon to present evidence regarding its OSS transition costs for line sharing and to explain how it intends to recover them. *Twenty-third Supplemental Order; Order on Reconsideration; Modifying Prior Order, in Part; Establishing Part D Proceeding Regarding OSS Transition Costs for Line Sharing and Self-Provisioned Entrance Facilities;* Docket No. UT-003013, Washington Utilities and Transportation Commission, p. 8.

Qwest argues the Telcordia charges are appropriate and reasonable. However, the record demonstrates that Qwest is a captive customer of Telcordia and that Telcordia's charges to Qwest are not cost-based.[81] Qwest's argument that the price it paid to Telcordia is its cost and should be treated just like the cost it pays for other items is not persuasive. The critical difference is that, because of Qwest's own choices, Telcordia is the only vendor to which Qwest can go for OSS modifications. Telcordia's prices are monopoly-based. There is no evidence that the price paid to Telcordia is reasonable, and that therefore the amount claimed by Qwest for cost recovery is reasonable. The federal and state statutes and rules require that prices be cost-based and that they be reasonable. The Consumer Advocate is correct that Qwest should not be allowed to recover expenses simply on presentation of an invoice.

The Consumer Advocate's position that Qwest benefits from the OSS modifications and therefore its cost recovery should be discounted is persuasive, although the benefit to Qwest is broader than the Consumer Advocate argues. The line sharing OSS modifications allow Qwest to retain the voice customer even when the customer has chosen a CLEC or DLEC to provide data service. In addition, the benefit to Qwest of the OSS modifications is that they allow Qwest to comply with the law and function in a competitive environment. The changes to OSS are a part of doing business in this competitive environment. Qwest must make things workable for its wholesale and retail customers, and the OSS modifications are designed to do

[81] Hunt Direct, pp. 22-23.

this. Finally, although it is difficult to quantify, Qwest has likely realized efficiencies in its back office systems due to the source code revisions.

The record does not contain adequate documentation to substantiate the $11.9 million recovery amount proposed by Qwest, and Qwest has not demonstrated that the $11.9 million payment to Telcordia was a reasonable cost for the work performed. Therefore, Qwest should not be allowed to recover the entire $11.9 million. However, Qwest has demonstrated that OSS modifications were performed, and it incurred both internal and external costs. There is no dispute regarding the reasonableness of Qwest's internal cost of $870,720, and Qwest provided an adequate explanation of the basis for the amount and the work performed.[82] Qwest also adequately demonstrated there is no double recovery for the $56,000 project management cost.[83] Therefore, Qwest should be able to recover part of the claimed cost. The OCA's recommendation to reduce recovery of the $11.9 million paid to Telcordia by 50 percent is persuasive and reasonable, given the record in this case. Therefore, the $11.9 million recovery amount will be reduced by 50 percent for the purpose of calculating the monthly recurring charge. The total amount to be recovered will therefore be $6,876,720.

The OCA and Qwest disagree on several methodology-related aspects of the calculation, which derives the monthly recurring charge for OSS modifications. One area of dispute involves applying a monthly or annual payment mode to the calculation. Qwest did not address the Consumer Advocate's recommendation to

[82] Qwest Responses to Questions, pp. 15-16.
[83] Qwest Responses to Questions, pp. 17-18.

use a monthly payment mode until it filed its reply brief. Qwest argues that this is an industry-accepted method for calculating this type of cost recovery. This method captures all relevant costs but spreads them throughout the year.[84] The Consumer Advocate argues that when payment is made on a monthly basis, as the CLECs will do, an annual payment basis is generally not used.[85] The Consumer Advocate's rationale is persuasive on this issue. It is reasonable and appropriate to match the payment basis in the calculation with the actual basis for recovering these costs.

Another area of dispute involves the application of a reasonable recovery period. The rationale used by the Consumer Advocate on this issue is persuasive. The life of line sharing is not necessarily based on a specific technology, but rather, on a concept that uses technology. However, 15 years is an unreasonably long recovery period, given the likely rapid changes in technology. Ten years will be used because it is a more reasonable recovery period over which to amortize these costs.

There is also dispute over the application of demand estimates in the computation of the monthly recurring charge for OSS modifications. Qwest states it used the best available data in estimating the demand for line sharing. Projections were developed for the first two years and trends were estimated from this information for five years.[86] The Consumer Advocate essentially accepts Qwest’s demand estimates, indicating that Qwest’s intuitive method may work as well as any other

[84] Qwest Reply Brief, pp. 9-10.
[85] Hunt Direct, p. 26.
[86] Brigham Direct, pp. 50-51.

method. The Consumer Advocate concludes that given the difficulty in estimating the demand for a service not yet offered, no one can project demand within plus or minus 10 percent of actual demand.[87]

However, the Consumer Advocate disagrees with the application of a discount rate to demand quantities. It argues that Qwest's application of a levelizing factor understates demand by 8 percent, inflates the OSS modification charge, and should be corrected by using the actual nondiscounted demand forecasted estimates.[88] Qwest applied the discount factor to the calculation as a short cut method for the purpose of levelizing periodic payments of unequal amounts. Qwest disagrees with Dr. Hunt's position that this results in over-recovery.[89]

The Consumer Advocate contends that the TELRIC components of the OSS charge should be calculated using a forward-looking demand estimate instead of the averaged demand estimate. Dr. Hunt testified the OSS charge should be calculated using the year 2005 demand projection.[90]

The Consumer Advocate points to a connection between the TELRIC "add on" of 28.5 percent for common overhead costs and the application of a forward-looking demand estimate. Dr. Hunt contends that if the Board considers a TELRIC "add on" to be appropriate, then the TELRIC demand level should be used in conjunction with

[87] Hunt Direct, p. 28.
[88] Hunt Direct, pp. 29-30; OCA Initial Brief, p. 8.
[89] Brigham Rebuttal, pp. 10-11.
[90] Hunt Direct, p. 33; OCA Initial Brief, pp. 9-10.

the TELRIC costs.[91] The Consumer Advocate's recommended recurring rates of $0.45 and $0.59 reflect the application of the year 2005-demand estimates and the inclusion of the directly assigned costs, directly attributable costs, and common costs.[92]

The application of the year 2005 demand estimates does not appear reasonable and would likely lead to under-recovery by Qwest.[93] With regard to the appropriateness of the directly assigned costs, directly attributable costs, and common costs, the record does not demonstrate that these costs are overstated or inappropriately applied. We do not agree with the Consumer Advocate's approach to apply the year 2005 demand estimates.

Qwest's argument regarding the appropriateness of levelizing the demand estimates is not persuasive. The Consumer Advocate's conclusion that it is inappropriate to levelize the demand estimates is correct.[94] Levelizing and discounting are typically applied to financial values. Furthermore, the record indicates that no forecast of future demand will likely be accurate to within 10 percent[95] and there is less than 10 percent difference between the proposed levelized demand value and the average annual demand value. Therefore, the

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[91] Hunt Direct, p. 33.
[92] OCA Initial Brief, p. 6.
[93] Brigham Rebuttal, p. 11.
[94] Hunt Direct, p. 29.
[95] *Id*., p. 28.

average annual demand level will be applied in calculating the monthly recurring charge for OSS modification.

Based on the above conclusions, Qwest should be allowed to recover $5.95 million of the $11.9 million payment made to Telcordia, the entire $870,720 related to internal costs to Qwest for OSS modifications, and the entire $56,000 in project management costs associated with the OSS modifications. The total amount to be recovered is $6,876,720.

In addition, the monthly recurring charge for recovering OSS modifications should be calculated using a monthly payment mode. It should be calculated using a ten-year recovery period, with a discount factor of 9.97 percent. The average annual demand in OCA Confidential Exhibit CEH-8 should be used. The directly assigned costs, directly attributable costs, and common costs are determined by the Qwest Cost Study I.D. # 5095 after the aforementioned inputs are established and applied.

Application of these findings results in a total monthly recurring charge of $1.02 for OSS line sharing modifications.

PRICES FOR UNCONTESTED UNEs AND SERVICES

Qwest has proposed prices for many other UNEs and services in this docket that were not set in Docket No. RPU-96-9.[96] The proposed prices are uncontested, are supported by Qwest studies, and will be approved subject to complaint or investigation.

[96] Qwest Exhibit IEW-1; Ms. Wilkens Direct, pp. 2-8.

FINDINGS OF FACT

1. Qwest has proposed a recurring, monthly charge of $5 for the HFPL. The Consumer Advocate suggests a charge of $3.02, and states that this is on the high end of reasonableness. Neither of these proposals is cost-based. Both are based on different economic theories. There are no cost-studies or other cost-based evidence to support them. Qwest's argument that the price it negotiated with competitors supports its proposal is not persuasive as discussed above.

2. Qwest has proposed a nonrecurring charge of $38.62 per loop for each shared loop for the HFPL. This proposal is uncontested.

3. There is no incremental cost to Qwest of the HFPL itself. Qwest will fully recover its incremental costs due to line sharing, including installation costs associated with provisioning the HFPL, through the nonrecurring charge, the price for OSS modifications due to line sharing, and through the other UNE and service prices approved in Docket No. RPU-96-9 and this docket.

4. The basis of the proposed $5 and $3.02 prices for the HFPL is an allocation of a portion of joint and common costs to the HFPL. However, Qwest is already fully recovering joint and common costs through the prices approved in Docket No. RPU-96-9.

5. Qwest did not allocate a portion of the shared or common loop costs to xDSL services when setting its interstate retail rates for those services.

6. The reasonable recurring monthly charge for the HFPL is $0.

7. Qwest has proposed a recurring, monthly rate of $3.41 for each line shared with a CLEC/DLEC to recover the costs it incurred for OSS modifications due to line sharing. The Consumer Advocate suggests a rate in the range between $0.45 and $0.59.

8. The evidence Qwest presented to support the claimed reasonableness of the amount paid to Telcordia is completely inadequate. Qwest should not be allowed to recover the entire amount it claims is due to line sharing OSS modification paid to Telcordia. Qwest has not presented any evidence that proves the amount is a correct allocation of the OSS modification expenses due to line sharing vs. those OSS modification expenses not due to line sharing. It has not presented any evidence that proves the $11.9 million is reasonable. It has not presented adequate evidence of what work Telcordia actually performed and how that relates to the claimed amount. As discussed above, the evidence shows the amount paid was a monopoly-based market price, was not cost-based, and was not reasonable.

9. The argument of the Consumer Advocate that Qwest receives a benefit from the line sharing OSS modifications and that the price paid to Telcordia should therefore be reduced is persuasive, although the benefit to Qwest is broader than that argued by the Consumer Advocate. As discussed above, Qwest benefits by being able to retain the voice customer when the customer chooses a CLEC or DLEC to provide data service, by complying with the law, by being able to function in a competitive environment, and by likely realizing efficiencies in its back office systems.

10. The $11.9 million claimed amount will be reduced by 50 percent, to $5.95 million, for the purpose of calculating the monthly recurring charge. Qwest has shown the $870,720 and the $56,000 amounts were reasonable and has adequately explained the basis of those amounts. Therefore, the total amount allowed for OSS recovery is $6,876,720.

11. In order to calculate the monthly recurring charge to recover this amount, the following principles are reasonable and will be applied. A discount rate of 9.97 percent and a monthly payment mode will be used. The recovery period will be ten years. It is inappropriate to levelize demand estimates, and to use estimated demand for the year 2005. The average annual demand level contained in OCA Confidential Exhibit CEH-8 will be applied. Application of these principles to the amount to be recovered results in a total monthly recurring charge of $1.02 for OSS line sharing modifications. This charge is reasonable.

12. The $5 HFPL price and $3.41 rate for OSS modification recovery proposed by Qwest are unreasonably high. Particularly when considered in combination with the nonrecurring rate for the HFPL and the charges for the other UNEs and services a CLEC/DLEC must have to interconnect, the prices would serve as a barrier to entry and are anti-competitive.

13. Qwest proposed prices for many other UNEs and services in this docket. The proposed prices are uncontested and are supported by Qwest studies.

CONCLUSIONS OF LAW

1. The Board has jurisdiction over the subject matter and parties in this proceeding. Iowa Code §§ 476.95, 476.101 (2001).

2. Iowa law requires incumbent local exchange carriers (ILECs) such as Qwest to provide access to unbundled essential facilities on terms and conditions that are reasonable, nondiscriminatory, cost-based, and tariffed. Iowa Code § 476.101(4)(a)(1) (2001).

3. Federal law requires that ILECs provide interconnection and access to unbundled network elements (UNEs) on "rates, terms, and conditions that are just, reasonable, and nondiscriminatory." 47 U.S.C. § 251(c)(2) and (c)(3); 47 C.F.R. § 51.307.

4. Federal law also requires that determinations by state commissions of the just and reasonable rate for interconnection and network elements be "based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the . . . network element," nondiscriminatory, and "may include a reasonable profit." 47 U.S.C. § 252(d)(1).

5. When the Board makes decisions regarding regulation of telephone companies, it must "consider the effects of its decisions on competition in telecommunications markets and, to the extent reasonable and lawful, shall act to further the development of competition in those markets." Iowa Code § 476.95(2) (2001).

6. The Board is to promote competition, not to favor one competitor over another. *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499, ¶ 618 (rel. Aug. 8, 1996) (FCC First Report and Order).

7. ILECs must unbundle the high frequency portion of the local loop and offer it to CLECS as an unbundled network element (UNE). FCC Line Sharing Order, ¶ 4; 47 C.F.R. § 51.319(h).

8. The FCC also established guidelines to assist states in applying its UNE pricing rules to line sharing. Line Sharing Order, ¶¶ 132 - 157. As the FCC stated, "Even if line sharing is made available to competitive LECs, however, it will not promote competition unless it is priced in a way that permits competitive LECs to enjoy the same economies of scale and scope as the incumbent LECs." Line Sharing Order, ¶ 133.

9. In setting prices in this case, the Board must consider the effect on competition of the aggregate of the price for the HFPL, the OSS line sharing modification price, and the prices for the other UNEs the CLECs must have to interconnect with Qwest's facilities. Iowa Code § 476.95(2) (2001); Line Sharing Order ¶ 133.

10. The FCC recognized that pricing the HFPL is different from pricing other UNEs and services in the Line Sharing Order, and stated: "We are thus presented with the question of how to establish the forward looking economic cost of

unbundled bandwidth on a transmission facility when the full embedded cost of that facility is already being recovered through charges for jurisdictional services." Line Sharing Order, ¶ 138.

11. The FCC concluded that states may require ILECs to charge "no more to competitive LECs for access to shared local loops than the amount of loop costs the incumbent LEC allocated to ADSL services when it established its interstate retail rates for those services." *Id. at* ¶ 139. Under this analysis, the price to be set for the HFPL would be $0, because Qwest stated it did not allocate a portion of the shared or common loop costs to xDSL services when setting its interstate retail rates for those services.

12. The FCC also stated "Currently, incumbent LECs are recovering the full embedded cost of their loops through revenues received from intrastate business and residential voice services, interstate access charges, and intrastate access charges. Nothing we do today affects the ability of incumbent LECs to continue to receive revenues from those services. Furthermore, the TELRIC methodology allows states to include in the price of an unbundled network element a reasonable allocation of forward-looking common costs. We anticipate, therefore, that states will set interim or arbitrated prices for line sharing to include forward-looking common costs . . ." Line Sharing Order, ¶ 152.

13. The Board established prices for a number of UNEs and services in its *Final Decision and Order,* Docket No. RPU-96-9, issued April 23, 1998. In its

decision, the Board fully compensated Qwest for its joint and common costs in the prices set for the loop, switching, and transport. *Final Decision and Order,* Docket No. RPU-96-9, pp. 15, 25-26. As the Board stated in that decision, "No additional shared and common cost recovery is needed from the other unbundled network elements." *Id.*

14. ILECs may not recover the same common costs multiple times from different elements, because any such recovery would be unreasonable and thus in violation of the statutory standard. FCC First Report and Order, ¶ 1698.

15. The FCC rejected value-based pricing methodology because the price for UNEs should be based on forward-looking costs, and setting the price based on the competitive value that the facility confers upon another party does not conform with the pricing principles set forth in the Line Sharing Order and the FCC First Report and Order. Line Sharing Order at ¶ 157.

16. The FCC found that ILECs "should recover in their line sharing charges those reasonable incremental costs of OSS modification that are caused by the obligation to provide line sharing as an unbundled network element." The FCC found this guideline to be consistent with the principle set forth in the FCC First Report and Order that ILECs cannot recover nonrecurring costs twice. It also reaffirmed that states may require ILECs to recover such nonrecurring costs as these incremental OSS modification costs through recurring charges over a reasonable period of time,

and that nonrecurring charges must be imposed in an equitable manner among entrants. Line Sharing Order at ¶ 144.

17. In its Final Decision and Order in U S WEST Communications, Inc., Docket No. RPU-96-9, the Board recognized that "unbundled essential facilities (UEFs)" under state law and "unbundled network elements (UNEs)" under federal law are similar, but not identical. Final Decision and Order, issued April 23, 1998, pp. 6, 11-12. However, U S WEST's state law tariff covered items that were both UEFs and UNEs, items that were only UEFs, and an item that was only a UNE. *Id.* at p. 11. It is appropriate that Qwest's state law tariffs continue to include all UNEs offered. Iowa Code § 476.101(5) (2001).

IT IS THEREFORE ORDERED:

1. The recurring, monthly charge for the HFPL is hereby set at $0.

2. The nonrecurring proposed price of $38.62 per loop for each shared loop for the HFPL is hereby approved.

3. The total amount to be recovered for OSS modifications due to line sharing is hereby set at $6,876,720.

4. The recurring, monthly charge for recovery of Qwest's expenses for OSS modifications due to line sharing is hereby set at $1.02.

5. The remaining uncontested proposed prices for UNEs and services not established in Docket No. RPU-96-9 are hereby approved.

6. Qwest's arguments in support of its proposed $5 HFPL price and $3.41 rate for OSS modification not specifically addressed in this decision are rejected as unsupported by the preponderance of the evidence, unpersuasive, or both.

7. Qwest's motion to file a surreply brief is granted.

8. On or before 30 days from the issuance of this order, Qwest must file a tariff in compliance with this order.

9. This proposed decision and order will become the final decision of the Board unless, within 15 days of its issuance, the Board moves to review the decision or a party files an appeal with the Board.

UTILITIES BOARD

/s/ Amy L. Christensen
Amy L. Christensen
Administrative Law Judge

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

Dated at Des Moines, Iowa this 25th day of March, 2002.